

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION**

IN RE:

DAISYTEK, INCORPORATED , *et al.*

Debtors

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**Jointly Administered Under
Case No. 03-34762 HDH-11**

**J. GREGG PRITCHARD, TRUSTEE
OF THE D.I.C. CREDITORS' TRUST**

Plaintiff

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vs

ERNST & YOUNG, LLP

Defendant

Adversary No. 05-3318

**MEMORANDUM OPINION ON MOTION TO
COMPEL ARBITRATION AND STAY PROCEEDINGS**

Came before the Court for hearing, the Motion to Compel Arbitration and To Stay Proceedings (“Motion”), filed by Ernst & Young L.L.P. (“E&Y”). The Court has jurisdiction pursuant to 28 U.S.C. §§ 1334 and 151, and the standing order of reference in this district. The matter is core, pursuant to 28 U.S.C. § 157(b)(2)(E)(F)(H)&(O).

J. Gregg Pritchard as Trustee of the D.I.C. Creditors Trust (“Trustee”) objected to the Motion on the grounds that a superseding confirmation plan and public policy void any arbitration clause. The Court took under advisement the Motion. After consideration, the Court grants the Motion as to the non-core claims and denies the Motion as to the core claims.

I. BACKGROUND FACTS

Daisytek, a company consisting of several subsidiaries, employed E&Y as its independent auditor from December 18, 2000 and July 15, 2003. An engagement letter, which contained an arbitration clause, was signed by the parties on March 31, 2001. That letter was supplemented several times and the parties continued to maintain an arbitration clause. Daisytek filed for Chapter 11 relief on May 7, 2003. On March 17, 2004, the Court confirmed the First Amended Joint Plan of Liquidation for the Debtors (“Plan”) which created the D.I.C. Creditor’s Trust and appointed J. Gregg Pritchard as Trustee. The Trustee commenced an adversary proceeding on May 4, 2005. In response, E&Y filed the Motion claiming the proceedings were in direct contravention to the arbitration agreement.

II. ISSUE

Is the Court allowed discretion in deciding whether to compel arbitration in the face of the Federal Arbitration Act (“FAA”) when presented with both core and non-core issues?

III. ANALYSIS

The Trustee's claims and the Motion meet at the intersection of the FAA and the Bankruptcy Code. The FAA dictates enforcement of arbitration agreements when there is a valid, written agreement and the contested issue falls within the scope of the agreement. *Shearson / American Exp., Inc. v. McMahon*, 482 U.S. 220, 226, 107 S. Ct. 2332, 2337 (1987). The FAA should be liberally applied in a fashion that "strongly favor[s]" the enforcement of arbitration agreements. *Pers. Sec. & Safety Sys. v. Motorola, Inc.*, 297 F.3d 388, 392 (5th Cir. 2002). This policy is not absolute. An exception to liberal application of the FAA is allowed when it would conflict with a congressional command, such as the Bankruptcy Code. *Shearson*, 482 U.S. at 226, 107 S.Ct. at 2337.

Core v. Non-core Distinction

A distinction is made between core and non-core issues in applying the exception to the FAA. "[I]f the court determines that a proceeding does not derive exclusively from the Code, the court has no choice but to abstain and allow the parties to arbitrate the matter." *In re Mirant Corp.*, 316 B.R. 234, 238 (Bankr. N.D. Tex. 2004)(applying *In re National Gypsum*, 118 F.3d 1056 (5th Cir. 1997)). The Trustee has brought some claims that are not exclusive to the Code. For this reason, the Court has no discretion to refuse enforcement of an arbitration agreement for the Trustee's non-core claims of professional negligence, negligent misrepresentation, breach of fiduciary duty, and participation in breach of fiduciary duty.

However, core claims require further analysis. While the distinction between core and non-core is important, all core claims do not "inherently conflict" with the FAA. *In re National Gypsum*, 118 F.3d 1056, 1067 (5th Cir. 1997). A conflict between arbitration and the claim brought under

the Code must be proven. In the present action, the Trustee's core claims concern turnover, avoidance of fraudulent transfers, and avoidance and recovery of preferential transfers.

In *In re Hagerstown*, a motion to compel arbitration was denied concerning a turnover claim.

In re Hagerstown Fiber Ltd. P'ship., 277 B.R. 181, 209 (Bankr. S.D.N.Y. 2002). The court determined that "[t]he turnover claim is core and compelling arbitration of the trustee's turnover claim would conflict with the important policies of the Bankruptcy Code." *In re Hagerstown*, 277 B.R. at 209. The arbitration agreement between Daisytek and E&Y allows for no monetary damages. This is in direct conflict with the provision of the Code for relief under a valid turnover claim. Due to this conflict, the Court is allowed discretion in denying the motion to compel arbitration of Trustee's turnover claim.

In *In re Gandy*, a claim for avoidance of a fraudulent transfer was deemed to be "derived entirely from federal rights conferred by the Bankruptcy Code." *In re Gandy*, 299 F.3d 489, 495 (5th Cir. 2002). Further, it was determined that such a claim "could present [a] type of conflict with the purposes and provisions of the Bankruptcy Code that may override the FAA's statutory directive of enforcement of arbitration agreements." *Gandy*, 299 F.3d at 499. *Gandy* is directly on point. Thus the Court can use discretion in considering retaining jurisdiction of the Trustee's avoidance of fraudulent transfer claim.

The type of conflict discussed in *Gandy* is also present in the Trustee's preference claim. In a case directly on point, the Bankruptcy Court for the District of Delaware concluded that preferential transfers are core issues and the "policies and objectives of the Bankruptcy Code would be seriously jeopardized by requiring arbitration of such claims." *Oakwood Homes Corporation v. American Bankers Insurance Co.*, 2005 WL 670310, *5 (Bankr. D.Del. 2005). Thus, the Court is

also allowed discretion to deny the motion to compel arbitration concerning these claims.

The Court reaches this conclusion, in part, after considering the issue of insolvency which will be presented in the numerous avoidance actions in this court and the policy of preventing piecemeal litigation. *In re National Gypsum*, 118 F.3d 1056, 1069 (5th Cir. 1997). Conflicts can be expected if these decisions are rendered in different forums at different times. *Oakwood Homes*, 2005 WL at *5. This Court regularly rules upon preferences and fraudulent transfer complaints. The bankruptcy court is well qualified to address the instant core claims. This Court's docket can accommodate an expeditious trial schedule for the turnover, preference, and fraudulent transfer claims. The determination of these claims expeditiously is in the interest of the estate and implements the plan. The determination of all turnover, preference, and fraudulent transfer claims by a single decision maker avoids inconsistent results.

Although the Trustee argues that a confirmed plan preempts any arbitration agreement, *Ernst & Young LLP & Baker O'Neal Holdings, Inc.*, 304 F.3d 753 (7th Cir. 2002), this Court disagrees. *Baker O'Neal* can be distinguished because of E&Y's high level of involvement in that plan compared to its non-existent involvement in the Daisytek plan. *Baker O'Neal*, 304 F.3d at 758. A confirmed plan of reorganization cannot preempt an arbitration agreement when E&Y had minimal involvement with such plan. *Id.* (distinguishing *In re Charter Behavioral Health Systems, LLC*, 277 B.R. 54 (Bankr. D.Del. 2002)).

IV. CONCLUSION

The Court is allowed no discretion as to non-core claims. Conversely, the Court is allowed discretion as to compelling arbitration on core matters when a conflict arises between the FAA and the Code. The Trustee's core claims conflict with the policies of the Code and the facts of the

instant case and applicable case law support denying the motion to compel arbitration of the core claims. The Motion to Compel Arbitration and To Stay Proceedings is granted as to the non-core issues of professional negligence, negligent misrepresentation, breach of fiduciary duty, and participation in breach of fiduciary duty. The same Motion to Compel Arbitration and To Stay Proceedings as to the core issues of turnover, avoidance of fraudulent transfer, and avoidance and recovery of preferential transfers is denied.

Counsel for E&Y shall submit a separate order consistent with this decision within ten (10) days.

***** END OF OPINION*****